Canadian Reserve Oil And Gas Ltd.

nineteen seventy-four annual report

74

CORPORATE INFORMATION

DIRECTORS

John R. McMillan, Los Angeles
Chairman of the Board and Chief Executive Officer,
Reserve Oil and Gas Company

Howard C. Pyle, Los Angeles
Petroleum Investments

Newton T. Bass, Apple Valley
Chairman of the Board, Emeritus,
Reserve Oil and Gas Company

Paul D. Meadows, Denver
President and Chief Operating Officer,
Reserve Oil and Gas Company

Maclean E. Jones, Q.C., Calgary
Partner,
Jones, Black, Gain & Laycraft

B. J. Westlund, Lake Oswego, Oregon
Retired Businessman

Cortlandt S. Dietler, Denver
President, Western Crude Oil, Inc.

CONTENTS

Corporate Information	Inside Front Cover
Highlights and Company Profile	1
Directors' Letter	2
Exploration, Development and Operations	3
Exploration and Development	3
Operations	12
Financial Review	15
Five Year Summary	Inside Back Cover

ANNUAL MEETING

The Annual General Meeting of Shareholders of the Company will be held at the Calgary Convention Centre, Calgary, Alberta, on April 23, 1975 at 10:00 a.m.

OFFICERS

John R. McMillan
Chairman of the Board and Chief Executive Officer

Paul D. Meadows
President

R. Bruce Bailey
Executive Vice-President and General Manager

J. E. Michaud
Vice-President

David W. Talbot
Vice-President and Treasurer

Donald A. Repka
Secretary

Grant D. Richards
Assistant Treasurer

Harold F. Green
Assistant Secretary

HEAD OFFICE

639 - 5th Avenue S.W.,
Calgary, Alberta

AUDITORS

CLARKSON GORDON & CO.
Calgary, Alberta

REGISTRAR

GUARANTY TRUST COMPANY OF CANADA
Calgary, Alberta

TRANSFER AGENT

GUARANTY TRUST COMPANY OF CANADA
Calgary, Alberta; Vancouver, British Columbia;
Toronto, Ontario; Montreal, Quebec

STOCK EXCHANGE LISTINGS

TORONTO STOCK EXCHANGE

MONTREAL STOCK EXCHANGE

HIGHLIGHTS 1974

	1974	1973	% Change
Gross revenue	$10,760,945	$8,999,791	+ 20
Cash flow	$ 6,567,569	$5,373,653	+ 22
Per share	$ .68	$ .56	
Net income	$ 1,946,343	$1,629,780*	+ 19
Per share	$ .20	$ .17*	
Working capital at year end	$ 2,982,677	$1,407,588	+112
Property and equipment additions	$ 5,097,399	$7,693,790	− 34
Oil and gas liquid sales —			
barrels	2,069,679	2,383,771	− 13
barrels per day	5,670	6,531	
Gas sales —			
Mcfs	6,070,998	5,937,703	+ 2
Mcfs per day	16,633	16,268	
Wells drilled — net			
Oil	6	19	− 68
Gas	4.3	6	− 28
Dry	12	18	− 33
Total	22.3	43	
Acreage — net working interest	9,657,255	10,232,547	− 6
Outstanding shares	9,635,037	9,613,397	+ .2

* Restated for change in deferred tax accounting policy.

COMPANY PROFILE

Canadian Reserve Oil And Gas Ltd., a successor to Fargo Oils Ltd., is a company continued under the Companies Act (Alberta) by virtue of an amalgamation of the company and a group of private companies on February 24, 1970. Canadian Reserve is an exploration and development company involved in the natural resource industry, concentrating its efforts in the search for and development of natural gas and crude oil reserves in Canada, and having interests in petroleum lands, pipelines, gas processing facilities and mining properties.

to the SHAREHOLDERS:

For Canadian Reserve the year 1974 was one of continued financial growth despite reduced exploratory and development activity. In summary, the financial gains, resulting in new high levels of achievement, were:

Net Income	— $ 1,946,000	Up 19%
Gross Revenues	— $10,761,000	Up 20%
Cash Flow	— $ 6,568,000	Up 22%
Working Capital	— $ 2,983,000	Up 112%

Improvement in prices received during the year for crude oil, natural gas and other products was the major contributing factor to the Company's favorable results. The average sales price for crude oil and natural gas liquids amounted to $3.54 per barrel in 1974 compared to $2.75 per barrel in 1973. Average natural gas prices increased from 13.0¢ per Mcf in 1973 to 20.0¢ per Mcf in 1974. Correspondingly, sulphur sales prices increased substantially from an average of $5.49 to $17.24 per long ton in 1974. A large part of the revenue gains derived from these higher selling prices was offset, however, by sharply increased operating costs, increased Provincial royalty costs and royalty surcharge rates on production, and by changes in Federal income tax provisions.

The Company's net production of crude oil and natural gas liquids declined by 13% in 1974 to an average of 5,670 barrels per day. This decline, the first in over seven years, was largely attributable to increased Provincial royalty rates and decreased exploratory and development drilling required to maintain or increase producing rates.

Net natural gas sales were up 2% to 16.6 million cubic feet per day, largely due to initial gas sales from one of the Company's jointly-owned Middle Devonian wells in the Kotcho area of British Columbia. The installation of facilities to connect two additional wells at Kotcho for delivery of some 4 million cubic feet per day net to the Company's interest was deferred until late 1975 due to gas price uncertainties, as a result of tax measures proposed by the Federal government.

Sulphur sales for the year totalled 30,460 long tons, as compared to sales of 39,645 long tons in the prior year. Sulphur sales in 1975 are expected to be in the order of 36,000 long tons at improved price levels.

Uncertainties created by frequent and uncoordinated changes in royalty and tax regulations imposed by the Provincial and Federal governments resulted in Canadian Reserve substantially reducing capital outlays for planned exploratory and development drilling programs during the year. Accordingly, the Company reduced its participation in the drilling of wells from 122 in 1973 to 67 in 1974. Although reduced in scope, this exploratory and development drilling activity met with considerable success.

In British Columbia, the Company participated in drilling 4 natural gas discoveries: in the Kotcho Lake, Monkman Pass and Tenaka areas, and an oil discovery in the Mike area.

Canadian Reserve, in Alberta, was a participant in 14 exploratory wells, resulting in 2 gas wells at Ethel and Medicine River and one oil well at Lobstick. The Company also participated in the drilling of 12 development wells, with 10 successful oil completions and 2 successful gas completions, in the province.

The Company was a participant in 22 wells in the heavy crude area of Alberta-Saskatchewan, resulting in 11 successful oil completions and 2 gas completions.

Unreasonably severe financial burdens were imposed by various governments during 1974 which threatened the economic viability of the entire oil and gas industry. Your Company and most of the industry recognize the urgency to expand exploration and development efforts to maintain Canada's unique and enviable position of self-sufficiency in energy supplies. The incentives and massive investments required to meet this challenge will be most difficult to obtain with frequent and uncoordinated changes in royalty and tax regulations where the governments involved claim a larger share of industry revenues. However, the governments involved have recently expressed an intention or have adopted regulations to improve the industry's net return from production. These changes are indications that an economic climate may soon be re-established which will be conducive to the revitalization of the petroleum industry in Canada. With these favorable signs increasing, the outlook for Canadian Reserve is excellent.

The Board of Directors wishes to once again express its sincere and deep appreciation for the keen interest and resourcefulness of its employees, which contributed to the continued success of the Company during the past year.

For the Board of Directors

Paul W. Meodas

President

EXPLORATION, DEVELOPMENT and OPERATIONS

R. B. Bailey, Executive Vice-President and General Manager.

During 1974 Canadian Reserve's major exploratory and development efforts were concentrated in the search for natural gas in northeast British Columbia, for oil reserves in the Heavy Crude region of Alberta-Saskatchewan, and for natural gas and oil in the lower risk areas of Alberta.

The Company participated in the drilling of 67 wells in Western Canada, a significant reduction of 46% from the 122 wells drilled in 1973. The reduction in drilling was entirely the result of increased Provincial royalty assessments, and the taxation policies of the Federal Government.

A summary of the Company's significant activities in 1974 follows:

EXPLORATION and DEVELOPMENT

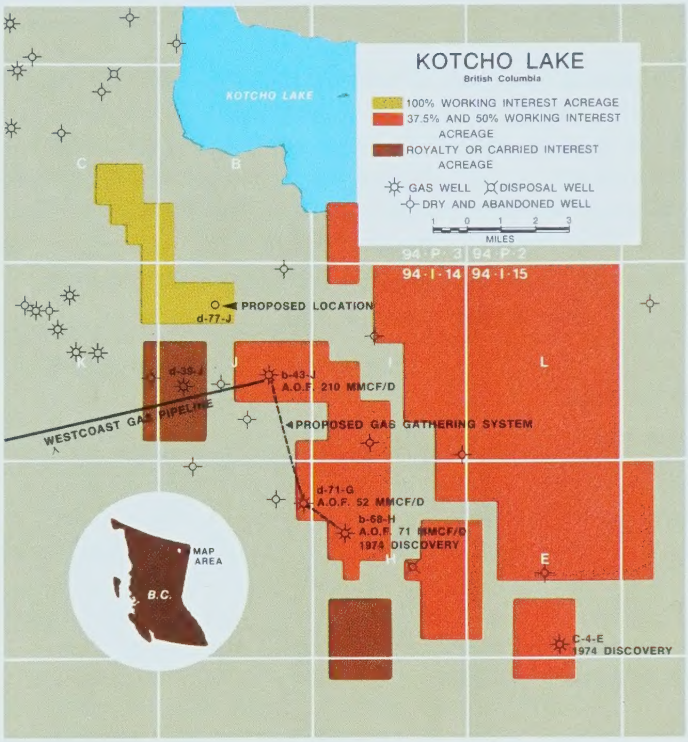
BRITISH COLUMBIA

During 1974, Canadian Reserve participated in drilling 5 discovery wells (4 gas, 1 oil) plus two potential natural gas wells in northeast British Columbia. The natural gas discoveries were in the Kotcho Lake, Monkman Pass and Tenaka areas, the oil pool discovery was in the Mike area and the potential natural gas wells were in the Jeans area.

Canadian Reserve's acreage holdings in British Columbia decreased from 607,355 (154,846 net) in 1973, to 544,937 (137,195 net) in 1974.

Kotcho Area

Two natural gas wells were drilled in this area in 1974. The first discovery, b-68-H, was completed in the Middle Devonian Reef member with an absolute open flow of 71 million cubic feet of natural gas per day and was drill stem tested at 2.09 million cubic feet of natural gas per day from the Cretaceous Bluesky formation. The second discovery, c-4-E, was drill stem tested at a rate in excess of 1 million cubic feet of natural gas per day from a Middle Devonian Reef member. This well is awaiting completion and production testing (See map on this page).



Exploration to date on Company lands in the Kotcho area has resulted in four gas wells, three of which have indicated dual production capabilities from the Cretaceous Bluesky as well as the Middle Devonian Slave Point formations. Further exploration and development will depend upon the favourable resolution of contending Federal and Provincial governmental tax measures.

An extensive gas gathering, dehydration and water disposal system was designed for the East Kotcho field to tie-in wells b-68-H and d-71-G to Westcoast Transmission's system located at the b-43-J well. The installation of this system which would increase the Company's net natural gas sales by approximately 4.0 million cubic feet of natural gas per day, has been delayed due to uncertainties created by governmental policies.

Canadian Reserve holds land interests which vary from 37.5% to 100% in 56,466 acres (29,383 net) in this area.

Tenaka Area

The Company, with partners, drilled a successful Middle Devonian natural gas well in 1974 at b-84-G, some 3 miles north of the original a-36-G discovery. Subsequent to year end, b-84-G has been completed and tested with an indicated open flow potential of 3 million cubic feet of gas per day.

Canadian Reserve owns an interest in 80,794 acres (19,372 net) in the Tenaka area.

Mike Area

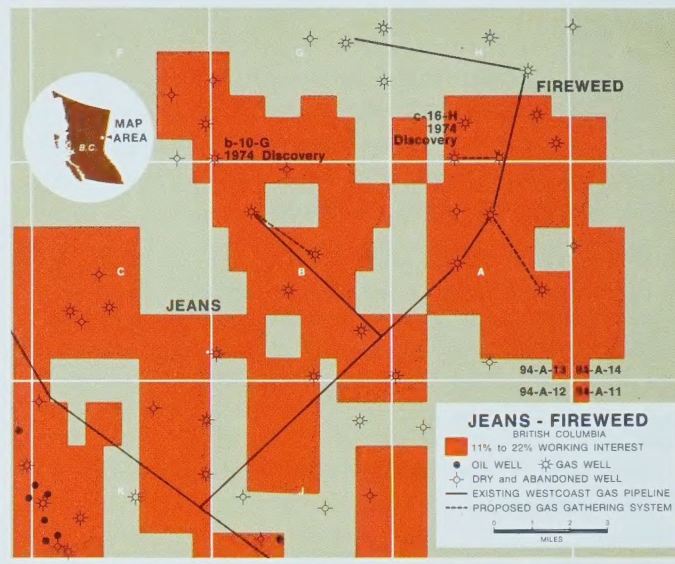
Canadian Reserve holds a 20% interest in an oil discovery drilled in this area during 1974. The non-operated well located in d-53-H, Buick Creek area, recovered 3,000 feet of 42° crude on a drill stem test of the Cretaceous Bluesky sand. Royalty rates currently in effect in British Columbia however make it uneconomical to proceed with follow-up development drilling.

Jeans-Fireweed Area

During 1974, the Company participated in the drilling of six wells in the Jeans-Fireweed area of northeastern British Columbia. Two of the wells were potential natural gas wells while the other four were dry holes.

Canadian Reserve owns working interests which average approximately 11.5% in 10 completed natural gas wells in this area. Westcoast Transmission Company plans to construct a line into the area during the summer of 1975. Canadian Reserve is participating in the installation of production and gathering facilities to initially connect 4 jointly owned wells. The Company's net natural gas production from the initially connected wells is estimated to be approximately 1.0 million cubic feet per day.

The Company owns interests in 16,628 acres (2,303 net) in the Jeans-Fireweed area (See map on this page).



ALBERTA

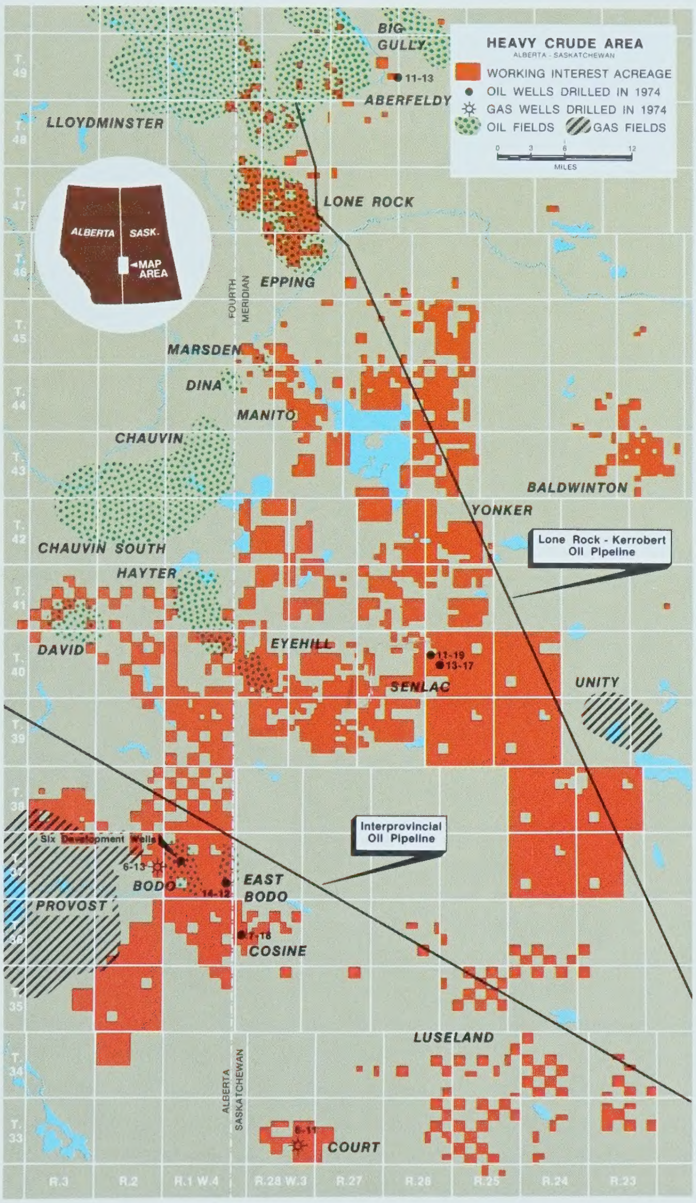
During 1974 Canadian Reserve participated in 14 (6.46 net) exploratory wells resulting in 2 natural gas wells at Ethel and Medicine River and one oil well at Lobstick. The Company also participated in 12 (2.14 net) development wells resulting in 10 oil wells and 2 natural gas wells in the province (See Map of Western Canada, centre fold).

Ethel Area

Canadian Reserve drilled a 4,000 foot wildcat east of Swan Hills resulting in a Cretaceous sand natural gas well which was drill stem tested at 4.8 million cubic feet per day. The well earned a 50% working interest in a 9 section block of land with further options to earn additional lands. Further exploration is intended for this area during 1975.

Lobstick Area

Canadian Reserve, as operator and 50% partner in an original 7,680 acre drilling reservation, participated in three Cardium formation tests on this prospect in 1974. Two wells were abandoned and the third was completed as an oil well with an initial production rate of 100 barrels of oil per day. Following lease selection from the drilling reservation, Canadian Reserve owns 50% of 1,920 lease acres (960 net acres).



This potential oil field is currently awaiting further development drilling to determine the extent and size of the oil and gas cap zones. Depending upon the outcome of the development program, the pool will be either waterflooded, with the gas cap remaining shut-in, or be placed on concurrent oil and gas production.

Swan Hills Area

Three successful development wells were drilled in this area during the winter season of 1973-74. Two of these wells were included in the Swan Hills Unit No. 1 as of August 1, 1974 resulting in an increase in the Company's share of Unit production, of 70 barrels of oil per day to 170 barrels of oil per day.

HEAVY CRUDE AREAS ALBERTA-SASKATCHEWAN

During the past year, Canadian Reserve participated in 10 (2.03 net) development wells resulting in 8 oil wells, one natural gas well, and one dry hole in the Heavy Crude areas of Alberta-Saskatchewan. The Company also participated in 12 (5 net) exploratory wells resulting in three oil wells, one natural gas well, and 8 dry holes in this area.

Development plans in Saskatchewan for the proven oil reserves at Lone Rock, Epping, and Eyehill were suspended due to the adverse economic effect of Saskatchewan Bill 42, and Federal Budget proposals announced in November, 1974.

The reservoirs in the Heavy Crude area are characterized by recoveries of only 5-8% of the original oil in place under conventional primary producing methods. The Company is investigating the application of additional enhanced recovery methods which could substantially add to recoverable oil reserves. These methods, however, require large expenditures, and the properties concerned must generate substantial revenues to justify proceeding with the projects.

The Company's gross land holdings in the Heavy Crude area increased by 30,000 acres in 1974 (See map on this page).

Court Area

The Company concluded option agreements, purchased a drilling reservation, and earned by farmin, to accumulate a total of 24,320 gross acres in this area. The farmin well resulted in a McLaren formation natural gas well with a drill stem test of 6 million cubic feet of natural gas per day.

Left to Right:
Roy H. Glover, Land Manager,
Lorne D. Howes, District Geologist,
Ronald W. Ambrose, District Geologist.

Senlac Area

Canadian Reserve participated for a 50% interest in the drilling of two exploratory wells on this prospect, which resulted in two oil wells. The Company also acquired a 50% interest in approximately 1,700 offset lease acres.

In addition to the exploration drilling in the Senlac area, the Company purchased partially developed properties. Immediate plans call for extensive production tests of existing wells on these properties using conventional and enhanced recovery techniques which, if successful, will result in the drilling of a number of development wells.

Bodo Area

Canadian Reserve participated in the drilling of 6 (1 net) development wells in this Heavy Crude area of Alberta. The wells were all completed as oil producers and are part of a continuing development project in this field.

The Company is participating in an experimental fireflood pilot in the main Bodo pool. It is anticipated that a minimum of 2 years will be required to meet the objectives of this experimental flood. A successful enhanced recovery scheme could add substantially to the Company's reserves in the Bodo field and other similar heavy oil areas, and lead to extensive development programs.

YUKON AND NORTHWEST TERRITORIES

Industry drilling activities were reduced in the Northwest Territories in 1974, with approximately 50 exploratory wells drilled as compared to 80 wells in 1973. Twenty-four wells were drilled in the Mackenzie Delta resulting in 4 natural gas discoveries bringing the total to date in the Delta to 17 successful completions (2 oil, 1 dual oil and natural gas, and 14 natural gas).

Drilling in the Delta is expected to remain active in 1975, in anticipation of approval for the installation of the Mackenzie Valley Pipeline. At year end, 11 rigs were on location in the Delta.

Colville Lake Area

During 1974 the Company participated in a significant natural gas discovery in the Colville Lake area where it is a major interest owner in Permit lands. The well, Ashland et al Tedji Lake F-24 was drill stem tested at 4.4 million cubic feet of natural gas per day from a Basal Paleozoic zone at an approximate depth of 3,800 feet. An extensive geophysical program designed to further pursue the prospect is scheduled for 1975.

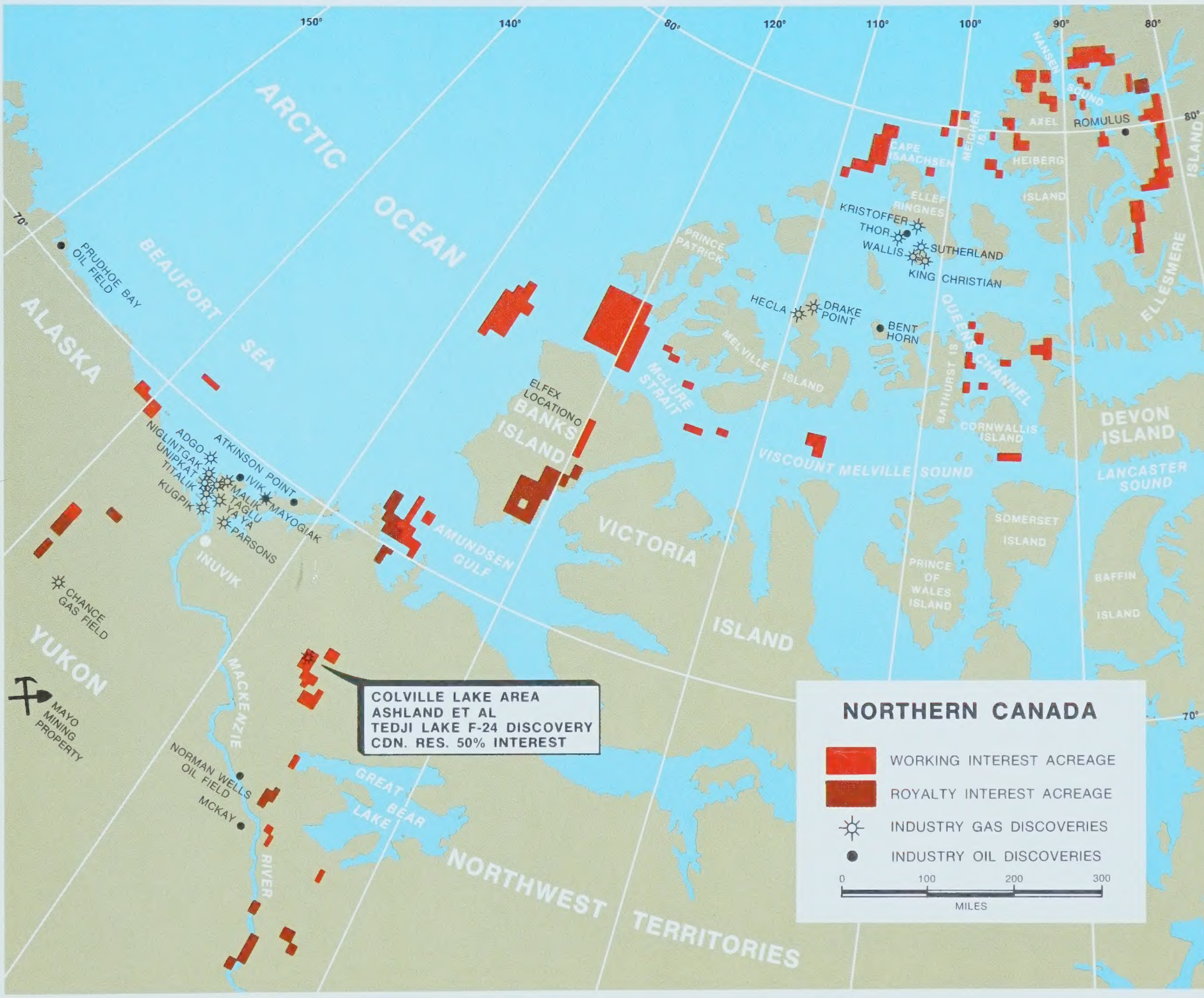
Canadian Reserve has concluded a farmout agreement by which another company has committed to expend Canadian Reserve's share of certain exploration expenditures on the Colville Lake project over the next two winter seasons. This expenditure should complete the extensive seismic program and a follow-up well to the Tedji Lake discovery. Canadian Reserve will retain a 25% interest in 664,428 Permit acres after the farmout expenditures.

In the Yukon and Northwest Territories the Company holds working interests in 1,850,529 acres (938,435 net) and overriding royalty interests in 1,331,999 acres (See map on opposite page).

ARCTIC ISLANDS

Three successful wildcats and one successful stepout were recorded by the industry in the Arctic Islands during 1974. The Dome Sutherland O-23 well discovered natural gas on King Christian Island while the Panarctic W. Hecla N-52 well discovered natural gas 8 miles offshore from Melville Island. The other discovery, also made by Panarctic, was noted when light crude oil was tested at the Bent Horn N-72 location on Cameron Island. This discovery is significant since it is the first recovery of live crude oil from the Paleozoic rocks which border the Sverdrup Basin. An extension to the Drake Point gas pool was made with the completion of Panarctic Drake Point D-68 as a natural gas well.

Canadian Reserve did not participate in exploratory drilling in the Arctic Islands during 1974, but followed with considerable interest the progress of the Dome Arctic Ventures Crocker I-53 well on Meighen Island. This well was abandoned above intended total depth



due to inoperable hole conditions and did not attain or test the principal objective of the well. Canadian Reserve has a 40% interest in 1,147,684 acres of nearby lands with similar potential.

Another interesting location is the Elfex et al Kusrhaak D-16 well offsetting Canadian Reserve working interest lands on Banks Island. At year end, this well was preparing to commence drilling and is intended as a 12,000 foot Paleozoic test.

The Company holds oil and gas rights on 8,970,757 acres (6,207,880 net) and has overriding royalty interests in 1,412,455 acres in the Arctic Islands (See map above).

SUMMARY OF CROWN AND FREEHOLD ACQUISITIONS IN 1974

	Gross Acres	Net Acres	Gross Cost	Company Cost
British Columbia	23,232	8,594	$ 275,421	$ 76,910
Alberta	12,412	3,138	257,228	54,691
Saskatchewan	104,178	53,129	636,605	324,768
Ontario	2,751	1,375	—	—
TOTALS	142,573	66,236	1,169,254	456,369

SUMMARY OF ACREAGE HOLDINGS

	Working Interests		Gross Overriding Royalty Interests
	Gross	Net	Gross
Oil and Gas Exploration Permits			
Yukon	503,574	214,901	148,472
Northwest Territories	1,346,955	723,524	1,183,527
Arctic Islands	8,970,757	6,207,880	1,412,455
Canadian East Coast Offshore	5,044,771	1,827,094	—
Petroleum and Natural Gas Rights			
British Columbia	544,937	137,195	51,524
Alberta	793,075	262,875	132,364
Saskatchewan	699,682	277,879	582,254
Manitoba	8,832	4,532	1,413
Ontario	2,751	1,375	—
TOTAL OIL AND GAS ACREAGE	17,915,334	9,657,255	3,512,009
Under Application			
East Coast Offshore	14,714,787	4,904,929	—

EASTERN CANADA

Exploration in Eastern Canada was highlighted by two discoveries recorded by the Eastcan Group in offshore Labrador waters. The Eastcan et al Bjarni H-81 and Eastcan et al Gudrid H-55 wells both tested considerable quantities of water-free natural gas from rumored large structures with thick reservoir sections. The H-81 well tested natural gas at 13 million cubic feet per day from an unspecified zone while the H-55 well tested 20 million cubic feet per day with condensate from selected intervals below 8,740 feet. These promising discoveries have considerably improved the outlook for Eastern Canada's offshore play. Canadian Reserve's 14.7 million acre (5 million net) block of Permit applications is located within the same basin as these discoveries but in deeper water.

Canadian Reserve owns 5,044,771 acres (1,827,094 net) of petroleum and natural gas rights off the East Coast of Canada in addition to its permit applications.

Arthur W. Goring,
Senior Mining Engineer

LAND

On December 31, 1974 Canadian Reserve held working interests in 17.9 million acres (9.6 million net) and overriding royalty interests in 3.5 million acres throughout Canada in the Western Provinces, Ontario, the Arctic Islands, the East Coast offshore, and the Yukon and Northwest Territories. Productive land holdings of the Company in the Western Provinces increased by 9,570 gross acres to 323,000 acres (89,000 net). Permit applications on the 14.7 million acres (4.9 million net) located off the East Coast of Canada are still in abeyance pending the issuance of new federal land regulations.

During 1974 the Company continued its policy of reducing the large work commitments on its Frontier holdings by means of farmout and work credit arrangements. Work credit agreements were concluded on the 347,094 acre Melville Sound block; on a portion (180,433 acres) of the Queens Channel block and on portions of the Nansen and Cape Isaachsen blocks in the high Arctic. In the Colville Lake area of the Northwest Territories, an agreement was concluded whereby another company will pay Canadian Reserve's 50% share of the next 3 million dollars to be expended on the project.

Work credits and farmout agreements negotiated during the past several years ensure that all Company lands in the Frontier areas of Canada will be carried at no cost to the Company.

During 1974 the Company acquired new holdings in the Western Provinces, however these acquisitions were limited to active drilling projects. As a result of the Federal taxation policies and Provincial royalty rate increases in the Western Provinces of Canada, the Company initiated a program of selective acreage reduction.

The Summary of Crown and Freehold Acquisitions in 1974 shown on the opposite page includes lands purchased in the Tenaka and Kotcho areas of British Columbia, the Goodridge Lake area of Alberta, and the Luseland, Court and Senlac areas of Saskatchewan.

HEAVY MINERALS EXPLORATION

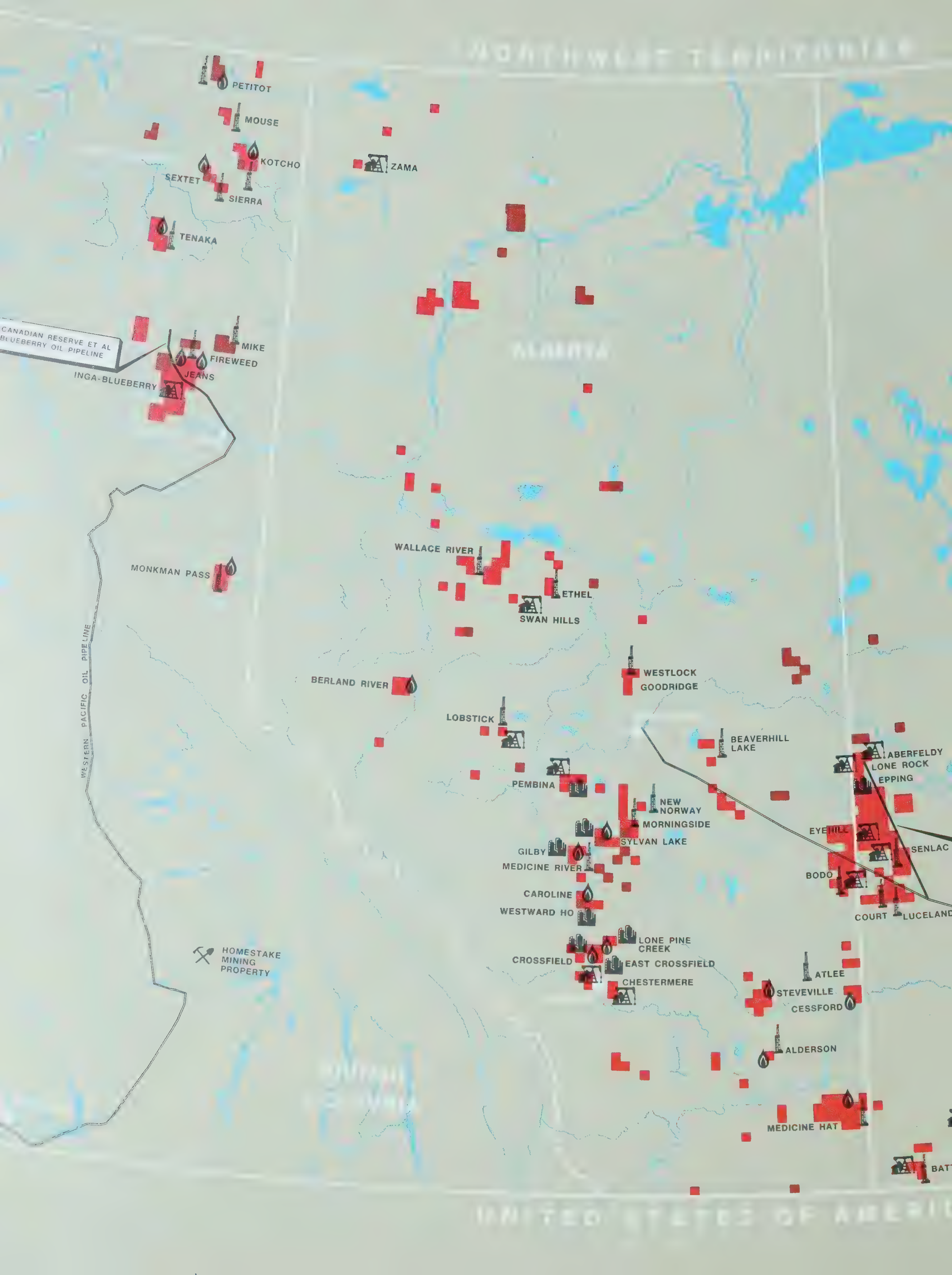
A limited heavy minerals exploration program was conducted during 1974, with a small joint venture program in the Mayo area of the Yukon Territory, a continuation of the program in the Kamloops area of British Columbia and the commencement of a joint venture program in the Ironbridge area of Ontario.

In the Mayo area, on Rambler Hill, further geochemical and geological work was conducted east of the area where work was conducted in 1973. Several new anomalies will be investigated during the 1975 season, in addition to the high grading of previous mineralized showings. All of this work was done under a joint venture agreement with Silver Spring Mines Ltd. (N.P.L.) in which Canadian Reserve is the operator and has a 60% interest in the properties.

In the Kamloops area of British Columbia, at the Homestake Mine, a 1,910 foot adit was driven into the hillside and a 446 foot raise to the upper level from this adit was completed. As reported in the 1973 Annual Report, an independent evaluation report of the Homestake properties has defined proven ore reserves of barite, silver, lead, zinc and copper in the order of one million tons. The Company's production plans have been deferred due to increased royalty and tax rates imposed during the year by the British Columbia Government.

At year end, the Company had spent approximately 1 million dollars in developing and acquiring the Homestake Mine and offset properties, thereby earning an estimated 46% position.

Another joint venture program was entered into with Silver Spring Mines Ltd. (N.P.L.) in the Ironbridge area of Ontario. Involved in this program are four claim groups and a 250 ton per day mill. The primary mineral is copper, with minor values in gold and silver. It is anticipated that the mill will be in operation by late February or early March of 1975. The copper concentrate will be shipped by rail to Noranda, Quebec. If all options under this agreement are exercised, Canadian Reserve will have earned a 45% interest in the claims and a 50% interest in the mill, with Silver Spring Mines as the operator.


NORTHWEST TERRITORIES
PETITOT
MOUSE
KOTCHO
SEXTET
SIERRA
TENAKA
ZAMA
ALBERTA
CANADIAN RESERVE ET AL
BLUEBERRY OIL PIPELINE
MIKE
FIREWEED
JEANS
INGA-BLUEBERRY
MONKMAN PASS
WESTERN PACIFIC OIL PIPELINE
WALLACE RIVER
ETHEL
SWAN HILLS
BERLAND RIVER
WESTLOCK
GOODRIDGE
LOBSTICK
BEAVERHILL
LAKE
PEMBINA
NEW
NORWAY
MORNINGSIDE
SYLVAN LAKE
GILBY
MEDICINE RIVER
CAROLINE
WESTWARD HO
ABERFELDY
LONE ROCK
EPPING
EYEHILL
SENLAC
BODO
COURT
LUCELAND
HOMESTAKE
MINING
PROPERTY
LONE PINE
CREEK
CROSSFIELD
EAST CROSSFIELD
CHESTERMERE
ATLEE
STEVEVILLE
CESSFORD
ALDERSON
MEDICINE HAT
UNITED STATES OF AMERICA


INTERPROVINCIAL
OIL
PIPELINE
VIRDEN
ROUTLEDGE
STEELMAN
DOUGLASTON
GLEN EWEN
MAP OF WESTERN CANADA SHOWING CANADIAN RESERVE PROPERTIES AND INTERESTS
WORKING INTEREST LANDS
CARRIED OR ROYALTY INTEREST LANDS
OIL PRODUCING AREAS
GAS PRODUCING AREAS
ACTIVE EXPLORATORY AREAS
PLANT SITES
0
32
64
96
128
MILES

OPERATIONS

Left to Right:
Joe R. Dundas, Manager of Production and Development
Jim A. Nelson, Drilling Supervisor
Gus A. Czeman, Chief Engineer

Drilling

Exploratory completions totalled 48 wells, resulting in 6 oil wells, 9 natural gas wells, and 33 dry holes for a success ratio of 31.3%. Canadian Reserve's interest in the successful exploratory completions resulted in 2.5 net oil wells and 3.4 net natural gas wells.

Canadian Reserve participated in the drilling of 19 development wells during the year, equivalent to 4.7 net wells. Of these, 13 were completed as oil wells, 5 as natural gas wells and 1 was abandoned, for a success ratio of 94.7%. Refer to the following table.

Wells Drilled

	Gross Wells		Net Wells	
	1974	1973	1974	1973
Development				
Oil	13	46	3.3	11.4
Gas	5	2	0.9	0.4
Dry	1	5	0.5	0.9
	19	53	4.7	12.7
Exploration				
Oil	6	16	2.5	7.6
Gas	9	15	3.4	5.2
Dry	33	38	11.5	16.9
	48	69	17.4	29.7
Total Wells	67	122	22.1	42.4

	1974	1973
Average Well Participation	33.0%	34.7%
Success Ratio (Gross)		
Development	94.7%	92.9%
Exploration	31.3%	43.1%

Production and Sales

For the first time in over seven years, the Company experienced a reduction in net crude oil and natural gas liquids sales. This reduction from a daily average during 1973 of 6,531 barrels to 5,670 barrels is a direct reflection of the significant increase in royalties claimed by the Alberta and British Columbia governments during the year.

Although the base royalty charged by the Saskatchewan Government was not altered, the introduction of a royalty surcharge, together with the proposed Federal Government surtax measures introduced during the year, compelled the Company to significantly reduce its projected exploration and development drilling programs. These reduced programs largely contributed to a reversal of the production rate growth pattern established in recent years.

Net natural gas sales during 1974 averaged 16.6 million cubic feet per day, a slight increase from the 1973 average of 16.27 million cubic feet per day. This nominal increase is attributable to new production from the East Kotcho area of British Columbia together with higher deliveries from the Lone Pine Creek Field in Alberta. The increases in these two areas were sufficient to slightly more than offset a large increase in the Alberta provincial royalty rates.

No substantial increases in natural gas sales are expected in 1975, primarily because additional natural gas reserves in the Kotcho area will not be placed on stream. A gas gathering system has been designed for the area, however, uncertainties created by governmental policies necessitated deferment of plans to tie-in these reserves during the 1974-75 winter season.

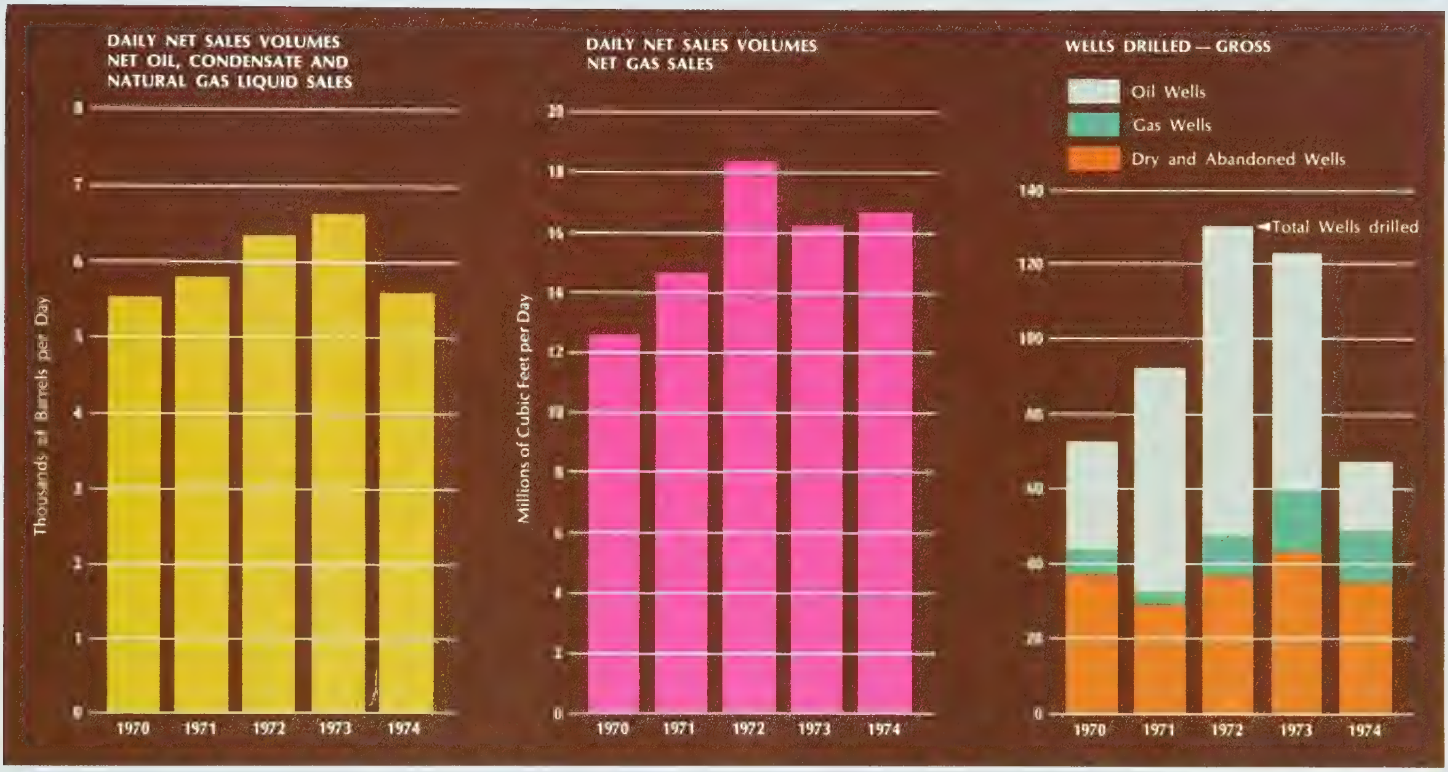
Net sulphur production during 1974 averaged 115 long tons per day for an increase of 2.7% from the 112 long tons per day in 1973. The Company sold 30,460 long tons during 1974 for an average net back price of $17.24 per long ton which was a significant increase from $5.49 per long ton received in the previous year.

During the last half of 1975, the Company plans to begin sales of sulphur production from its properties in the Lone Pine Creek area.

Natural Gas Processing

Canadian Reserve owns interests ranging from 0.67% to 33.3% in 7 natural gas processing plants in Alberta. The Company's most significant plant interests are in the Crossfield, East Crossfield, Sylvan Lake and Lone Pine Creek fields of Alberta.

Canadian Reserve owns a 33.3% interest in the Lone Pine Creek processing facilities. This plant treats the sour and wet natural gas from the Devonian D-1 formation underlying Canadian Reserve acreage in the Lone Pine Creek field. The Company's share of plant output during 1974 amounted to 1,763 million cubic feet of sales gas, 40,900 barrels of condensate, and 14,031 long tons of sulphur.



Canadian Reserve owns an approximate 12% interest in natural gas processing facilities in the East Crossfield area, 30 miles northeast of Calgary. The Company's share of plant products from these facilities during 1974 amounted to 1,348 million cubic feet of sales gas, 11,400 barrels of condensate, and 30,460 long tons of sulphur.

Total throughput in the East Crossfield Elkton Plant facilities was reduced during 1973 and 1974 due to a concurrent oil and gas production ruling by the Energy Resources Conservation Board. Development drilling during 1973 and subsequent production performance from the down-dip oil zone has reduced substantially the magnitude of the associated oil pool. As a result, it is anticipated that higher rates of natural gas production will be allowed during 1975.

Transportation

Canadian Reserve owns a 47.5% interest in the 101-mile Lone Rock-Kerrobert pipeline system which transports a crude oil-condensate blend from the Lloydminster area of Saskatchewan to connect with Interprovincial Pipeline at Kerrobert, for delivery to the Ontario and Chicago marketing areas.

During 1974 the Lone Rock-Kerrobert Pipeline delivered 3,018,000 barrels of blend to the Interprovincial line. This averaged 8,268 barrels per day, a decrease of 3% from the 1973 daily average of 8,566 barrels per day. This reduction was caused mainly by a decrease in exploratory and development drilling in the Heavy Crude area due to uncertainties caused by governmental policies, together with a reduction in sales to the United States markets during the month of November brought about by an excessive export tax.

In northeastern British Columbia, Canadian Reserve owns a 21.67% interest in a 72-mile pipeline which transports crude oil from the Aitken Creek, Blueberry and Inga fields to Taylor Flats for movement via other pipelines to West Coast refineries. This system is capable of handling 15,000 barrels of crude oil per day.

CRUDE OIL, CONDENSATE AND NATURAL GAS SALES
(net after deducting royalties)

	CRUDE OIL AND CONDENSATE SALES			NATURAL GAS SALES		
	1974%	Barrels		1974%	MCF	
	Distribution	1974	1973	Distribution	1974	1973
BRITISH COLUMBIA						
Blueberry		56,400	73,300		256,200	236,600
Inga		54,100	108,500		235,200	344,900
Kotcho		—	—		389,100	—
Other fields		100	—		4,900	—
	5.344	110,600	181,800	14.584	885,400	581,500
ALBERTA						
Bodo		15,800	9,200		—	—
Cessford		—	100		170,900	208,900
Crossfield		31,900	46,400		694,000	823,600
Crossfield East		49,500	69,700		1,347,700	1,544,100
Fenn Big Valley		35,300	44,700		19,100	2,200
Lobstick		1,800	—		—	—
Lone Pine Creek		40,900	40,100		1,762,600	1,672,700
Medicine Hat		—	—		70,100	103,100
Medicine River		103,900	147,500		872,900	803,400
Pembina		122,900	121,900		10,300	—
Swan Hills		26,900	28,700		18,900	15,800
Other fields		54,400	55,700		144,400	121,800
	23.351	483,300	564,000	84.186	5,110,900	5,295,600
SASKATCHEWAN						
Battle Creek		15,300	10,500		—	—
Cantuar		34,400	40,800		—	—
Flat Lake		28,100	23,400		—	—
Forget		34,200	18,100		—	—
Lone Rock/Epping		1,202,500	1,378,200		—	—
Steelman		49,200	51,900		—	—
Other fields		43,800	37,200		74,400	60,600
	68.005	1,407,500	1,560,100	1.230	74,400	60,600
MANITOBA						
North Virden		58,700	65,100		—	—
Other fields		9,600	12,800		—	—
	3.300	68,300	77,900	—	—	—
	100.0	2,069,700	2,383,800	100.0	6,071,000	5,937,700

FINANCIAL REVIEW

Left to Right:
David W. Talbot,
Vice President and Treasurer
Donald A. Repka,
Corporate Secretary and Manager, Law Department
Grant D. Richards,
Assistant Treasurer and Chief Accountant

Gross Revenue

Gross revenue increased $1,761,000 to $10,761,000 for the year 1974. This increase is the result of improvement in prices of crude oil, natural gas, natural gas liquids and sulphur. This improvement was minimized by increased government royalties and the introduction of royalty surcharges. These additional levies resulted in a decrease of the Company's net share of production from the levels attained during the past few years.

Crude oil net sales for the year averaged 5,332 barrels per day at an aggregate price of $3.44 per barrel. This compares to average daily production during 1973 of 6,178 barrels at an average price of $2.74 per barrel. Crude oil sales provided approximately 60% of the Company's gross revenue.

Natural gas liquids received substantial price adjustments during 1974, rising from an average of $2.81 per barrel for 1973 to $5.35 per barrel for 1974. Although increased royalties reduced the Company's net sales volumes, the price adjustments more than offset this reduction and thus the Company's gross income from product sales increased from $363,000 to $660,000 during the year.

Improvements in gross natural gas production during the year were adequate to offset the increases in provincial royalties levied, resulting in a slight increase in net natural gas sales volumes. The daily average net sales of 16.6 million cubic feet received an aggregate price of 20 cents per MCF, representing a 7-cent per MCF increase over the aggregate price for 1973.

Following several years of depressed market conditions, sulphur experienced a substantial price recovery during 1974. From an average price for 1973 of $5.49 per long ton, it increased to $17.24 per long ton. Gross income from sulphur sales increased from $218,000 in 1973 to $525,000 in 1974.

Expenses

Operating expenses increased 15% over 1973 to $2,957,000. This increase is primarily the result of the general inflation experienced during 1974.

General and administrative costs rose 24% during 1974. Without the inclusion of non-recurring items, the increase for 1974 would have been 16%.

Cash Flow

Cash flow generated from operations, which consists of net income before deduction of all non-cash items, increased $1,194,000 or 22% to $6,568,000 for the year. These funds, equivalent to 68 cents per share, financed all of the Company's capital expenditures incurred during the year.

Depreciation and Depletion

Depreciation and depletion expenses decreased $120,000 to $2,499,000. The write-offs for oil and gas properties and production equipment are based on the unit-of-production method. This method takes into account the Company's share of the total net volume of oil and gas and product sales for the year in relation to the total net reserves expressed in equivalent barrels of crude oil. Natural gas and sulphur are converted to equivalent barrels of crude oil based on the year end unit values of each. As the price of natural gas and sulphur increased considerably more than that of crude oil during 1974, the equivalent barrels of reserves of these products were increased substantially over those computed at the end of 1973. This calculated increase in reserves together with the slight decrease in net sales volumes, resulted in a smaller amount of property and equipment write-offs for 1974.

Income Taxes

Provision for deferred income taxes increased $1,040,000 to $2,100,000 for 1974. This increase is due primarily to the revision of the federal tax laws whereby all income receivable after May 6, 1974 by governments from the Company properties, through royalties, royalty surcharges or similar payments, are deemed income to the Company for tax computation purposes. Such payments to governments by the Company from May 7 to December 31, 1974 have amounted to approximately $4,700,000.

Current taxes payable for 1974 had been estimated at $800,000. However, recent steps taken by some provincial governments to relieve the industry from paying taxes on non-received income have partially offset this improper financial burden. Consequently, no current taxes are considered payable in respect of the Company's 1974 operations.

The substantial increase in taxable income resulting from resource taxation changes introduced November 18 by the federal government has made it necessary for the Company to apply against 1974 earnings the remainder of its development and exploration expenses carried forward from previous years in order to maximize the retention of funds for future exploration and development. It is therefore expected that under the present tax laws the Company will be faced with a substantial corporate tax in the year 1975.

Net Income

Net income increased $317,000 or 19% over the restated figures for 1973. The 1973 restatement was necessary to account for additional deferred taxes due to a change in accounting policy. This change provides for income tax deferred on **all** timing differences between income for accounting and income for tax purposes. Prior to this change, the Company provided for taxes deferred on timing differences only for depreciable items.

Property and Equipment Additions

Property and equipment additions in 1974 amounted to $5,097,000, down 34% from 1973. This decrease is largely due to the termination or deferment of planned capital expenditures made necessary by changes in governmental policies.

The distribution of 1974 expenditures was $2,717,000 for the drilling of wells, $806,000 for well and lease equipment, $398,000 for leasehold acquisitions, $477,000 for exploration overhead, $372,000 for delay rentals, and $327,000 for miscellaneous other projects. The geographical distribution of these expenditures was: Alberta 41%, British Columbia 32%, Saskatchewan 17%, Northern Canada 4%, and other areas 6%.

Working Capital

Working capital at year end totaled $2,983,000 compared to $1,408,000 a year earlier. The working capital ratio has therefore increased from 1.8 to 1 to 2.4 to 1. Production loans at December 31, 1974 were $2,690,000, of which $600,000 is payable during 1975 and thus has been included in the current liabilities.

1975 Outlook

Forecasts for 1975 have been revised several times in recent months to account for the ever-changing government policies and regulations governing the resource industry. Original forecasts of revenue after taxes and capital expenditures were drastically reduced following the November 18 federal budget. Recently announced changes in provincial government regulations have been aimed at moderation of the drastic effect of the federal budget proposals. There are now indications that the year 1975 will see a return to economic realism by the federal and provincial governments and thus permit the industry to proceed with exploration and development programs. It is not possible at this time to reasonably predict the final outcome of federal-provincial competition for revenues from the petroleum industry, and thus the Company's financial performance.

Throughout 1974 the Company has monitored closely the changes in governmental attitudes and regulations, and in order to minimize the potential impact of these changes has concentrated on improving its financial position. This policy will be continued during 1975 in order to enhance the Company's ability to reinstitute an aggressive exploration and development program upon the return of economic stability in the Canadian petroleum industry.

CANADIAN RESERVE OIL AND GAS LTD.
(Incorporated under the Laws of the Province of Alberta)

Balance Sheet December 31, 1974 and 1973

	1974	1973
ASSETS		
CURRENT:		
Cash	$ 586,500	$ 271,457
Accounts receivable	2,983,552	2,016,365
Inventory of sulphur and crude oil, at the lower of cost and estimated realizable value	744,321	548,259
Materials and supplies, at average cost	690,827	237,822
Prepaid expenses	56,425	34,968
	5,061,625	3,108,871
SUNDRY INVESTMENTS AND DEPOSITS (at the lower of cost and market)	97,250	78,364
PROPERTY AND EQUIPMENT AT COST (Note 1):		
Oil and gas properties	35,890,890	31,783,839
Production equipment	10,124,504	9,321,979
Plants, pipelines and other equipment	7,273,450	7,232,741
	53,288,844	48,338,559
Less:		
Accumulated depletion	11,225,163	9,529,717
Accumulated depreciation	6,409,317	5,704,226
	35,654,364	33,104,616
	$40,813,239	$36,291,851
LIABILITIES		
CURRENT:		
Accounts payable and accrued expenses	$ 1,478,948	$ 1,101,283
Current portion of bank production loans (Note 3)	600,000	600,000
	2,078,948	1,701,283
BANK PRODUCTION LOANS (Note 3)	2,090,000	2,090,000
DEFERRED INCOME TAXES (Notes 1, 2 and 6)	8,770,000	6,670,000
SHAREHOLDERS' EQUITY:		
Share capital (Note 4) —		
Authorized:		
20,000,000 common shares having a nominal or par value of $1.00 each		
Issued:		
9,635,037 shares (1973 — 9,613,397)	9,635,037	9,613,397
Contributed surplus	5,888,725	5,812,985
Retained earnings (Note 2)	12,350,529	10,404,186
	27,874,291	25,830,568
	$40,813,239	$36,291,851

On behalf of the Board:

John R. McMillan Director.

Paul W. Meadows Director.

See accompanying notes.

Statement of Income
Years Ended December 31, 1974 and 1973

	1974	1973
Revenue:		
Gross operating revenue	$10,601,986	$8,954,188
Other	158,959	45,603
	10,760,945	8,999,791
Expenses:		
Operating	2,957,068	2,566,923
General and administrative	911,859	732,257
Depreciation	803,111	833,061
Depletion	1,695,446	1,785,113
Interest on long term debt	320,580	195,279
Other	26,538	197,378
	6,714,602	6,310,011
Income before income taxes	4,046,343	2,689,780
Provision for deferred income taxes (Notes 1, 2 and 6)	2,100,000	1,060,000
Net income for the year	$ 1,946,343	$1,629,780
Net income per share (Note 8)	$ .20	$ .17

Statement of Retained Earnings
Years Ended December 31, 1974 and 1973

	1974	1973
Balance, beginning of year, as previously reported	$15,554,886	$13,115,106
Less adjustment for change to full tax allocation accounting (Note 2)	5,150,700	4,340,700
As restated	10,404,186	8,774,406
Net income for the year	1,946,343	1,629,780
Balance, end of year	$12,350,529	$10,404,186

Statement of Contributed Surplus
Years Ended December 31, 1974 and 1973

	1974	1973
Balance, beginning of year	$5,812,985	$5,300,690
Consideration over par value for shares issued during the year (Note 4)	75,740	512,295
Balance, end of year	$5,888,725	$5,812,985

See accompanying notes.

Statement of Changes in Financial Position
Years Ended December 31, 1974 and 1973

	1974	1973
Source of funds:		
Net income for the year	$1,946,343	$1,629,780
Depletion, depreciation, deferred income taxes and other non-cash items, net	4,621,226	3,743,873
Cash flow from operations	6,567,569	5,373,653
Increase in long term portion of bank production loans	500,000	590,000
Proceeds from sale of property and equipment	102,018	61,521
Proceeds from sale of investments	9,480	23,697
Issue of share capital for cash	21,640	36,470
Issue of share capital for properties	—	500,500
	7,200,707	6,585,841
Application of funds:		
Additions to property and equipment	5,097,399	7,693,790
Acquisition of investments	28,219	18,887
Repayment of bank production loans	500,000	—
	5,625,618	7,712,677
Increase (decrease) in working capital	1,575,089	(1,126,836)
Working capital, beginning of year	1,407,588	2,534,424
Working capital, end of year	$2,982,677	$1,407,588

See accompanying notes.

Auditors' Report

To the Shareholders of
Canadian Reserve Oil And Gas Ltd.

We have examined the balance sheet of Canadian Reserve Oil And Gas Ltd. as at December 31, 1974 and the statements of income, retained earnings, contributed surplus and changes in financial position for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion these financial statements present fairly the financial position of the company as at December 31, 1974 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year after giving retroactive effect to the adoption of full tax allocation accounting as explained in Note 2 to the financial statements.

Clarkson, Gordon & Co.
Chartered Accountants.

Calgary, Canada.
February 4, 1975.

Notes to Financial Statements

December 31, 1974

1. **Summary of significant accounting policies**

Property and equipment

The Company follows the full-cost method of accounting wherein all costs related to the exploration for and the development of oil and gas reserves, whether productive or non-productive, are capitalized and depleted by relating the total production for the year to the total estimated proven reserves. Depreciation of production equipment is provided on the same basis as depletion, and plants, pipelines and the majority of other equipment are depreciated on the straight line method at rates varying from 5% to 10%.

Income taxes

The Company accounts for income taxes by the tax allocation method whereby the income tax provision is based on earnings reported in the accounts.

2. **Change in accounting policy**

In prior years the Company made no provision for income taxes deferred as a result of claiming for tax purposes drilling, exploration and property acquisition costs in excess of the amounts provided in the accounts for related depletion and amortization charges.

In 1974 the Company retroactively adopted the practice of full tax allocation accounting whereby provision is made for deferred income taxes for all transactions which affect book and taxable income in different years. The effect of this change was to decrease 1974 earnings by $1,900,000, decrease 1973 earnings by $810,000 and to charge $4,340,700 to retained earnings at January 1, 1973.

3. **Bank production loans**

Bank production loans are secured by certain producing properties and repayments in the amount of approximately $600,000 are required annually.

4. **Share capital**

Employees' stock purchase plan

Under an employees' stock purchase plan 21,640 shares were issued to officers and employees. The excess of the fair market value at the date of grant over the exercise price of $1.00 per share totalled $75,740 and was charged to earnings and credited to contributed surplus.

Stock option plan

During the year, no options were granted or exercised under the stock option plan and options to purchase 13,600 shares were cancelled. At December 31, 1974 options granted to officers and employees to purchase 160,400 shares were outstanding. These options are exercisable at various dates to August 1983 at a price of $3.20 per share. In addition, the Company has reserved 34,700 shares for the granting of future options to officers and employees.

5. **Commitments and contingencies**

The Company has deposited with government authorities non-interest bearing demand notes aggregating $1,013,133 at December 31, 1974 as security for the performance of work obligations in respect of certain exploratory rights.

The Company has guaranteed letters of credit to other companies in the amount of $12,632.

6. **Income taxes**

The current provision for deferred income taxes has been computed by taking into account the federal budget proposals of November 18, 1974 and various provincial rebate programmes introduced since that date, none of which have yet been enacted into law. Had these proposals not been taken into account, the 1974 provision would have been reduced by approximately $650,000.

While the Company has not been required to pay income taxes in 1974, the government changes referred to above have compelled the Company to utilize for income tax purposes substantially all of its drilling, exploration and property acquisition costs. Accordingly the Company may be required to pay a substantial amount of income taxes in 1975.

7. **Statutory information**

Directors and senior officers (including the five highest paid employees) received remuneration and benefits amounting to $212,257 during 1974.

8. **Net income per share**

Net income per share is based on the average number of shares outstanding during the year. The exercise of the outstanding share options would have no dilutive effect on net earnings per share.

FIVE YEAR SUMMARY

	1974*	1973*	1972*	1971*	1970
FINANCIAL					
Gross Revenue	$10,760,945	$8,999,791	$7,360,246	$6,347,451	$5,254,742
Cash Flow	6,567,569	5,373,653	4,685,420	3,759,544	2,801,749
Depreciation and Depletion	2,498,557	2,618,174	2,153,317	1,666,549	1,132,617
Deferred Taxes	2,100,000	1,060,000+	952,000+	839,000+	584,300+
Extraordinary Items	—	—	—	(51,910)	(590,808)
Net Income	1,946,343	1,629,780+	1,381,049+	1,305,905+	1,195,715+
Per Share					
Gross Revenue	1.12	.94	.77	.67	.60
Cash Flow	.68	.56	.49	.40	.33
Income before Extraordinary Items	.20	.17+	.14+	.13+	.07+
Net Income	.20	.17+	.14+	.14+	.14+
Property and Equipment Additions	5,097,399	7,693,790	5,661,141	6,608,426	2,981,673
Working Capital	2,982,677	1,407,588	2,534,424	2,038,631	2,292,332
Outstanding Shares	9,635,037	9,613,397	9,526,282	9,516,226	8,516,226
OPERATING					
Oil and Gas Liquid Sales - Barrels	2,069,679	2,383,771	2,333,792	2,108,450	1,997,891
— Barrels per day	5,670	6,531	6,377	5,777	5,474
Gas Sales — Mcf	6,070,998	5,937,703	6,691,018	5,330,410	4,612,591
— Mcf per day	16,633	16,268	18,282	14,604	12,637
Sulphur Sales — Long Tons	30,460	39,645	47,330	27,965	38,016
— Long Tons per day	83	109	129	77	104
Wells Drilled — Gross (net)					
Oil	19(6)	62(19)	83(29)	62(15)	28(14)
Gas	14(4)	17(6)	10(2)	3(1)	7(3)
Dry	34(12)	43(18)	37(12)	28(13)	38(11)
Total	67(22)	122(43)	130(43)	93(29)	73(28)

* Figures for 1971 to 1974 are on the full cost method of accounting. Prior years have not been restated to this method.

\+ Restated for change in deferred tax accounting policy.

SMITH GRANT MANN ALBERTA
Litho'd in Canada

Canadian Reserve Oil And Gas Ltd.
nineteen seventy-four annual report